BEFORE THE
PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2012-3-E

In the Matter of Annual Review of Base Rates for Fuel Costs for Duke Energy Carolinas, LLC	)))))	**DIRECT TESTIMONY OF MARION ELLIOTT BATSON FOR DUKE ENERGY CAROLINAS, LLC**

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Marion Elliott Batson, and my business address is 526 South Church Street, Charlotte, North Carolina 28202.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am Manager, Coal Supply for Duke Energy Business Services, LLC ("DEBS"). DEBS is a service company subsidiary of Duke Energy Corporation ("Duke Energy"), which provides services to Duke Energy and its subsidiaries, including Duke Energy Carolinas, LLC ("Duke Energy Carolinas" or the "Company").

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I am a 1985 graduate of the University of South Carolina with a Bachelor of Science in Business Administration. I have been employed with Duke Energy since 1986 and have worked in various fossil fuel procurement functions and leadership roles since 1990. I am a member of the North Carolina Coal Institute.

Q. PLEASE DESCRIBE YOUR DUTIES AS MANAGER OF COAL SUPPLY FOR DUKE ENERGY CAROLINAS.

A. I am responsible for managing the purchase and delivery of coal that Duke Energy Carolinas and the other Duke Energy regulated subsidiaries use for the generation of electricity.

Q. HAVE YOU TESTIFIED BEFORE THIS COMMISSION IN ANY PRIOR PROCEEDINGS?

A. Yes. I have testified in the Company's annual fuel filings before this Commission for the past several years, including the 2011 fuel filing in Docket No. 2011-3-E.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to furnish information relating to the Company's fossil fuel purchasing practices and costs for the period of June 1, 2011 through May 31, 2012 (the "review period"), and to describe changes forthcoming for the period of October 1, 2012 through September 30, 2013 (the "billing period").

Q. YOUR TESTIMONY INCLUDES TWO EXHIBITS. WERE THESE EXHIBITS PREPARED BY YOU OR AT YOUR DIRECTION AND UNDER YOUR SUPERVISION?

A. Yes.

Q. PLEASE PROVIDE A DESCRIPTION OF THESE EXHIBITS.

A. The exhibits provide the following information:

Batson Exhibit 1 – Fossil Fuel Procurement Practices

Batson Exhibit 2 – Fossil Fuel Detail: Purchases, Consumption, and Inventories

Q. CAN YOU PROVIDE A SUMMARY OF DUKE ENERGY CAROLINAS' FOSSIL FUEL PROCUREMENT PRACTICES?

A. Yes. The Company continues to follow the same procurement practices it has historically followed, which include establishing appropriate inventory requirements; regular requests for proposals and bid evaluation; balancing long-term contract and spot purchases; staggering contract expirations; pursuing contract extension options; maintaining a well-diversified supplier base; and actively

monitoring supplier and railroad performance. A summary of those practices is set out in Batson Exhibit 1.

Q. PLEASE DISCUSS THE COMPANY'S COST OF FOSSIL FUEL FOR THE REVIEW PERIOD.

A. A summary of Duke Energy Carolinas' costs, as well as other statistical information, for each fossil fuel category for the review period is set forth on Batson Exhibit 2. This exhibit includes the quantities purchased and consumed, the weighted average purchase price for each fuel, and the inventory balances beginning and ending the review period. Because several components make up the total cost of coal, coal statistics are broken down to show the average freight-on-board mine cost, the transportation cost, and the delivered cost per million British thermal units.

The delivered cost per ton of coal increased approximately 3.5% from an average of $93.49 for the period of June 2010 to May 2011 (the "prior review period"), to an average of $96.77 for the review period. The average mine price per ton of coal increased approximately 1.5% from an average of $67.75 for the prior review period, to an average of $68.70 for the review period. The average transportation rate per ton of coal increased approximately 9% from an average of $25.74 for the prior review period, to an average of $28.07 for the review period. Transportation costs constituted 29% of the Company's total delivered cost of coal during the review period.

The average oil cost for the review period increased 19% to $3.15 per gallon compared to the prior review period. The increase in oil is due to much higher global and United States ("U.S.") oil prices during the review period. Oil, natural

gas, and biomass product combined accounted for approximately 8% of the Company's total fossil fuel costs during the review period.

Q. WHERE DOES THE COMPANY SOURCE COAL AND WHY?

A. The Company's primary source of coal supply continues to be the Central Appalachia ("CAPP") region. As stated in previous testimony, the design of the Company's Carolinas plants is optimized around CAPP coals, and most of the Company's experience is with those coals. Fuel switching to a different coal basin is difficult because coal quality characteristics vary greatly between coal producing basins. Although the operational and environmental impacts of different coal qualities can be estimated through the Company's engineering models, a complete understanding—and accurate economic assessment—can only be obtained through a properly designed coal test program. Such a test program can often take up to a year at an individual station depending on the station's design and the specific properties of the candidate coal.

Due to the challenges facing CAPP mining operations, coal production in this key region is on the decline. As a result of declining supply and price disadvantages compared to other coal regions such as Northern Appalachia ("NAPP") and Illinois Basin, the Company is actively pursuing expanding its volumes of non-CAPP coals. Although only 10% of the Company's total coal supply in 2011 was sourced from non-CAPP sources, as much as 30% of its coal supply could be sourced from non-CAPP sources over 2012 and 2013.

Q. WHAT IS NEEDED TO ALLOW THE COMPANY TO CONSUME NON-CAPP COAL?

A. Actual hardware and operational adjustments necessary to burn non–CAPP coal are being evaluated at this time. The Company implemented a test burn program to test different coals at its scrubbed stations. Testing of Illinois Basin coal blends at Allen Station is on-going as plant run time allows. Testing of NAPP coal at Cliffside Station Unit 5 is also on-going as run time allows. Blends of NAPP coal have become the norm during the first half of 2012 at Belews Creek Station. And increasing volumes of NAPP coal have occurred at Marshall Station during the first half of 2012. Information developed through these and other tests will shed light on operational and environmental issues and/or benefits, and allow the Company to determine the lowest cost approach. Continued testing to determine the impacts of burning coal with very different coal quality characteristics combined with additional experience and knowledge shared by legacy Progress Energy, Inc., ("Progress Energy") personnel through the Duke Energy and Progress Energy merger will help the Company develop longer term procurement and operating strategies to achieve the lowest cost for its customers.

Q. PLEASE DESCRIBE THE LATEST TRENDS IN COAL MARKET CONDITIONS.

A. Coal markets continue to be in a state of flux due to a number of factors, including (1) introduction of new U.S. Environmental Protection Agency ("EPA") regulations for power plants that result in utilities retiring or modifying plants, which lower total domestic steam coal demand, and can result in some plants shifting coal sources to

different basins; (2) continuing growth in global demand for both steam and metallurgical coal, which makes coal exports increasingly attractive to U.S. coal producers; (3) historically low gas prices combined with installation of new combined cycle generation by utilities, especially in the Southeast, which also lowers overall coal demand; and (4) increasingly stringent safety regulations for mining operations, which result in higher costs and lower productivity. In addition, CAPP mining operations face unique challenges which are resulting in changes in production levels which lead to higher production costs. These include (1) the continuing decline in the quality of coal reserves, which increases the costs of mining; (2) a near moratorium by the EPA on water permits for new mines; (3) significantly better profit margins for metallurgical coals (vs. steam coals), causing a shift in investments for new mines to be focused on metallurgical coals; and (4) continued consolidation in ownership of CAPP coal properties, which has the effect of reducing competition.

Published market spot prices for all coal basins have decreased significantly over the last six to nine months. High-sulfur Illinois basin coal prices are trending down from the mid to upper $40s in the fall of 2011, to the upper $30s per ton for the remainder of 2012. Similarly, CAPP coal prices have decreased from approximately $80 per ton in the fall of 2011, to the mid to upper $50s per ton for the remainder of 2012, and to the mid to upper $60s per ton for 2013. The biggest drivers for these pricing changes are sharply falling natural gas prices, extremely mild weather during the winter of 2011 and 2012, very high utility coal inventory levels, and recent declines in demand for export coal. According to recent coal

industry publications, the national coal burn for December 2011 through February 2012 was more than 23% below average. Overall utility inventories increased by as much as 22 million tons in the U.S. (compared to a typical average decrease of 15 million tons). According to the same industry publications, coal inventories at U.S. power plants as of the end of February 2012 were more than 45 million tons above normal.

Prices of CAPP coal are expected to be relatively stable for the near term. Looking forward, however, the Company sees potential for market volatility as market uncertainties continue and coal suppliers continue to cut production and bring supply into balance with demand. Recent announcements by coal companies such as Alpha Natural Resources, Patriot Coal Company, and Consol Energy have conveyed their respective plans to reduce 2012 production. Another factor that can impact market pricing is the on-going financial viability of coal producers. Patriot Coal Company filed for bankruptcy on July 9, 2012, in light of the tough market and economic conditions facing the company. Current market conditions threaten the existence of many suppliers and could lead to further consolidation of the industry. Finally, continued low natural gas prices will pressure coal generation, especially in the most expensive coal regions like CAPP. All of these events lead to uncertainty of market conditions over the longer term.

Q. HOW DO YOU EXPECT THESE TRENDS TO AFFECT DUKE ENERGY CAROLINAS' COAL BURN?

A. Due to increasingly lower power prices and reduced demand for coal generation, coal burn projections for 2012 and forward have been adjusted downward. As an

example of the impact, actual coal burn for Duke Energy Carolinas' stations from December 2011 through February 2012 were approximately 43% less than the coal burn over the prior five-year average of the same months. Based on the low actual burns for December 2011 through February 2012, as well as the downward projection for coal burns in 2012 as compared to the amount of coal under contract for delivery in 2012, the Company expects coal inventories to be well above target levels during 2012 and 2013. The Company is evaluating alternatives to help mitigate inventories including (1) negotiating contract shipment deferrals / buy-outs, and (2) coal resell opportunities. Due to lower coal demand, these options would likely be difficult to achieve without paying additional costs to the supplier or incurring sales at a loss.

Q. WHAT IS THE PROJECTED AVERAGE DELIVERED COAL COST FOR THE BILLING PERIOD?

A. Combining coal and transportation costs, the Company projects average delivered coal costs of approximately $103.08 per ton for the October 2012 through September 2013 billing period excluding any fuel savings initiatives being pursued as a result of the Duke Energy and Progress Energy merger. Fuel savings from these initiatives are being passed on to customers through the implementation of the fuel decrement further described in the testimony of Company witness McManeus. Purchasing coal from new coal regions and/or non-traditional sources, increased purchasing power resulting from the Duke Energy and Progress Energy merger that leads to lower commodity prices, and potential coal transportation savings are all examples of initiatives being pursued. This cost, however, is subject to change

based on (1) market changes in coal prices for un-purchased coal, if any; (2) changes in oil prices, which impact transportation rates; (3) potential additional costs associated with suppliers' compliance with legal and statutory changes, the effects of which can be passed on through coal contracts; (4) performance of contract deliveries by suppliers and railroads which may not occur despite the Company's strong contract compliance monitoring process; (5) cost of potential contract volume deferrals in light of declining coal burn projections and high coal inventories; and (6) the amount of non-CAPP coal the Company is able to consume.

Q. DO THE COMPANY'S COAL PROCUREMENT PRACTICES DESCRIBED IN BATSON EXHIBIT 1 NEED TO CHANGE AS A RESULT OF THE CHANGES IN THE COAL MARKETS THAT YOU HAVE DISCUSSED?

A. No. The fundamentals of Duke Energy Carolinas' procurement practices are sound. The Company is, and intends to continue, conducting test burns of coals from alternative supply regions at several steam stations over the next few years. This effort, if effective, will add to the diversity of suppliers and coal-producing basins noted in the procurement practices and offset the coal producer consolidation impacts described below.

Q. HOW DOES THE COMPANY INTEND TO MANAGE ITS COAL COSTS FOR THE BILLING PERIOD?

A. Duke Energy Carolinas continues to maintain a comprehensive coal procurement strategy that has proven successful over many years in limiting average annual coal price increases and maintaining average coal costs near or well below those seen in

the marketplace. Aspects of this procurement strategy include having the appropriate mix of contract and spot purchases, staggering contract expirations so the Company is not faced with price changes for a significant percentage of purchases at any one time, and pursuing contract extension options that provide flexibility to extend terms within some price collar. The Company has developed a well-diversified coal supplier base in the CAPP region, although consolidation among the coal producers is making it increasingly difficult to accomplish this objective.

The Company maintains and complies with coal contract target guideline ranges covering four years forward. This structured approach provides a way to manage coal market price risks while providing cost stability and supply reliability. Purchases are competitively bid in accordance with the Company's procurement practices, and actual purchases, if any, will take into account actual and projected coal burns, as well as growing coal inventory levels noted earlier in my testimony.

Q. PLEASE EXPLAIN THE COMPANY'S FUEL INVENTORY POSITIONS.

A. Batson Exhibit 2 shows inventories at the end of the prior review period and at the end of the current review period. Coal inventories increased from 3,533,181 tons as of May 31, 2011, to 5,100,193 tons as of May 31, 2012, which equates to 69 days of full load burn. This significant increase in coal inventory is due to much lower than expected coal generation over the last six to nine months due to extremely mild winter weather and increased natural gas generation. Oil inventories for the review period decreased approximately 21% as compared to the prior review period. Also shown on Exhibit 2 is inventory for biomass wood product for co-firing purposes.

Q. WHAT COSTS FOR LIME PRODUCT ARE INCLUDED IN THE COMPANY'S PROPOSED FUEL FACTORS?

A. For the billing period, lime product will be consumed at Marshall, Belews Creek, Cliffside, and Allen Stations. Projected use at each plant varies, but consumption will be approximately 72,225 tons per month. Lime product supply for Marshall, Belews Creek, and Allen has been secured from a central Virginia source under a long-term supply contract that was competitively bid and entered into in 2004. In early 2010, an additional lime product supply contract was competitively bid for deliveries into Cliffside to accommodate completion of Unit 6 and secured from a Kentucky source under a long-term supply contract. Additionally, multi-year rail contracts have been established for all plants to support delivery of lime product. As with coal, the Company also actively monitors vendor and transporter performance for lime product as a cost controlling function. Total lime product expenses are projected to be approximately $22.5 million for the billing period. Overall, the Company is managing the impacts to all reagents, favorable or unfavorable, as a result of changes to the fuel mix (as I discuss earlier) and/or changes in coal burn (as discussed by Company witness Miller) due to competing fuels.

Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?

A. Yes, it does.

Duke Energy Carolinas Fossil Fuel Procurement Practices

Coal

- Near and long-term consumption forecasts are computed based on factors such as: load projections, fleet maintenance and availability schedules, coal quality and cost, environmental permit and emissions considerations, wholesale energy imports and exports.
- Station and system inventory targets are determined and designed to provide: reliability, insulation from short-term market volatility, and sensitivity to evolving coal production and transportation conditions. Inventories are monitored continuously.
- On a continuous basis, existing purchase commitments are compared with consumption and inventory requirements to ascertain additional needs.
- All qualified suppliers are invited to make proposals to satisfy any additional or future contract needs.
- Contracts are awarded based on the lowest evaluated offer, considering factors such as price, quality, transportation, reliability and flexibility.
- Spot market solicitations are conducted on an on-going basis to supplement contract purchases.
- Delivered coal volume and quality are monitored against contract commitments. Coal and freight payments are calculated based on certified scale weights and coal quality analysis meeting ASTM standards. During the test period the Company utilized both destination and origin weights and analysis.

Fuel Oil

- Consumption forecasts are generated by the same system that produces coal estimates. No. 2 diesel is burned for initiation of coal combustion (light-off at steam plants) and in combustion turbines (peaking assets).
- All diesel fuel is moved via pipeline to terminals where it is then loaded on trucks for delivery into the Company's storage tanks. Because oil usage is highly variable, Duke relies on a combination of inventory and reliable suppliers who are responsive and can access multiple terminals. Diesel is replaced on an "as needed basis" as called for by station personnel with guidance from fuel procurement staff.
- Formal solicitation for supply is conducted annually. Contracts are awarded based on the lowest evaluated offer with special value on suppliers' demonstrated ability to move large volumes of fuel with minimal notice.

DUKE ENERGY CAROLINAS
2012 SOUTH CAROLINA ANNUAL FUEL FILING
FOSSIL FUEL DETAIL
JUNE 2011 - MAY 2012

Coal _/1

Tons Burned		11,947,445
Tons Purchased		13,562,062
Avg. Mine Price/Ton	$	68.70
Avg. Freight Price/Ton	$	28.07
Avg. Delivered Price/Ton	$	96.77
Avg. Delivered Price/MBTU	$	3.95
Inventory as of 5/31/2011		3,533,181
Inventory as of 5/31/2012		5,100,193

Biomass

Tons Burned		18,659
Tons Purchased		19,975
Avg. Delivered Price/Ton	$	42.64
Inventory as of 5/31/2011		904
Inventory as of 5/31/2012		2,222

Fuel Oil

Gallons Consumed		5,222,673
Gallons Purchased		8,966,135
Avg. Delivered Price/Gal	$	3.15
Inventory as of 5/31/2011		15,292,040
Inventory as of 5/31/2012		18,513,467

_/1 Coal data excludes terminal activity.